

## Mass unemployment is the national policy

by David Goldman

April's 7 percent unemployment rate is not merely proof that the United States is entering a "deep recession," as most of the commentators suggest, but that unemployment is an intentional feature of public policy. No one should be deceived that a \$25 billion tax cut, as proposed by the Business Council and various economists to counteract the apparent severity of the downturn, will have significant effect on the economy. What is at work is something more fundamentally wrong than anything that occurred in the 1974-75 period.

What is qualitatively new in the bad news announcements of the past two weeks is that the part of the economy which was artificially protected by expectations of hefty military orders and strong Federal support for energy-autarky schemes has begun to unravel. As *EIR* reported in its survey of the American economy last month, the difference between September-March 1974-75 and September-March 1979-80 lies in the "mix" of the economy between consumer and capital goods. Although the two downturns were comparably severe in the consumer industries, total industrial production did not fall over the past eight months, although it fell by 15 percent during the earlier recession period.

Now, in bits and pieces, the capital goods sector is starting to unravel. U.S. Steel, which lost some forty percent of its orders during April, is now operating at 60 percent of capacity. A wave of mass layoffs is now following in steel, after a similar wave in auto. The first important breaks in capital spending plans have been reported. National Steel announced the reduction of its spending plans by 20 percent, along with other steelmakers. Even more significant is Ford's announcement of a

\$2.5 billion reduction of capital spending plans for the present year.

Such capital spending was not an elective for Ford Motor Co., which must downsize its cars by 1985 to meet EPA regulations or cease to function as a major American automaker. The strong implication, already suggested by highly-placed Washington sources, is that Ford will drastically reduce its unprofitable domestic operations, now running at a deficit rate of between \$1.5 and \$2 billion p.a., in favor of more profitable foreign operations. Also significant is the speculative collapse of defense and aerospace industry stocks on the New York market, despite continued efforts of analysts to promote them on grounds that the United States is moving towards a war economy in the long term.

On the energy side, all the talk about multi-billion dollar investments in synthetic fuels plants has not yet materialized in the form of hard Federal dollars. It is still not clear whether the demonstration plant built by Exxon, American Natural Resources, and other firms, and funded by a group of gas-using utilities, will survive foot-dragging in Washington.

For reasons stated clearly by Manufacturers Hanover economist Irwin Kellner, the conjunction of a collapse in capital spending on top of the devastation of the consumer sector means mass unemployment:

... the pace at which jobs were created during the expansion that began in April 1975 was nothing short of phenomenal. This reflected a fortunate confluence of two elements of demand and supply. The supply of people willing to work was there



*An unemployment line in New York. "Simple arithmetic tells us that if the 1974-75 recession brought unemployment to a peak of 9 percent, the current recession will reach a peak of 12 percent unemployment if the overall downturn is of comparable severity."*

*Photo: NSIPS*

because of the two- and three-income family ... The demand for workers matched supply because of the shift in the economy towards labor-intensive, low-productivity industries ... if this recession spreads across a whole host of consumer industries, as I think it will, then layoffs will occur in services, retailing and white-collar industries in general. It stands to reason that if it took more than the usual number of workers to increase output in a labor-intensive sector, it will take a layoff of more than the usual number of workers to decrease output if these sectors run into difficulty. And, I would remind you, that unlike past cycles, families won't have credit to turn to, since lending institutions have virtually shut off the credit tap in the wake of the mid-March policy tightening.

Simple arithmetic tells us that if the 1974-1975 recession brought unemployment to a peak of 9 percent, the current recession will reach a peak of 12 percent unemployment if the overall downturn is of comparable severity. These figures, of course, do not include workers who have stopped looking for work, gone onto welfare, or otherwise disappeared from the count at the unemployment centers, or potential labor force entrants excluded from the workforce due to adverse conditions, or an entire range of labor force participants otherwise excluded. The actual unemployment rate now is above 10 percent when these categories of unemployment are added to the official totals—assuming that the Bureau of Labor Statistics count is honest.

However, drastic as the prediction of 12 percent

unemployment may seem, that is the least of the economy's problems. The bigger problem is that, if events proceed linearly on their present course, the economy will never recover.

*EIR* demonstrated in the cited survey, through a computer simulation employing the LaRouche-Riemann model, that by 1981 the American economy will no longer be capable of replacing obsolesced and deteriorated plant and equipment, after five years of negative net capital formation, after the deduction of real depreciation. It is intuitively obvious that the costs of lost capacity utilization and lost skills in the workforce associated with prolonged idleness will bring us to this point faster.

But the round of current developments demonstrate that it is not merely a question of *when* the American economy will undergo the phase change which we earlier described as "thermodynamic death," but also, what sort of phenomena are associated with the period approaching such a phase change. In this sense the London *Economist's* criticism of Federal Reserve Chairman Paul Volcker is *superficially* correct; the *Economist* wrote, "Like a teenager with a new sports car, the Fed has spent the first six months at its new controls learning that it can accelerate fast and brake hard. It has still to master-cruising at a steady pace within the speed limit."

However, the *Economist* is drastically in error when it assumes that a middle course exists in the first place. The intention of the Carter administration, as *EIR* reported in depth over the past several months, was explicitly to turn out the results that pertained through March: to butcher the consumer sector of the economy and build up the military and quasi-military sectors of the econo-

my, including energy autarky. The administration was lifting entire pages of Nazi Finance Minister Hjalmar Schacht's manual of 1933-1938. Its chosen instrument for this reorganization was the Federal Reserve Board, which received more power at the hands of Rep. Henry Reuss than Schacht ever enjoyed at the Reichsbank, and the semi-secret Federal Emergency Management Agency, the successor of the Strategic Bombing Survey and the Office of Preparedness. What the administration wanted was precisely what we saw until April.

How mindlessly stupid this policy is became evident when bank newsletters appeared this week describing the change of the economy's "mix" between capital and consumer goods, at the moment that the capital goods side of the economy began to break. The Morgan Guaranty Survey, for example, wrote in its May issue, "At present, there are few signs of imminent weakness in business capital spending. Indeed, most investment indicators do not suggest any sudden deterioration of outlays on plant and equipment. Moreover, there is a distinct absence of the speculative excesses that were an important element of the capital-spending collapse of 1974-75." Manufacturers Hanover also called the consumer the "biggest negative this time around."

We have published the results of computer simulation of the policy described above in some detail, but the basic problem is simple: concentration of investment in either non-productive industrial sectors, e.g., military goods, or in the least-efficient of available technologies, e.g., synthetic fuels, produces a tendency towards hyperinflation, for the simple reason that the incremental capitalized value of the equity and debt associated with such ventures exceeds the total value added to the economy. The "success" of Volcker's restrictions against consumer credit, combined with an open door to credit for capital spending in such areas and a 30 percent p.a. increase in the rate of military spending, gave us a 20 percent inflation rate by early this year.

The Volcker March 16 credit controls package,

whose most devastating provision was the overall limitation of credit extension by commercial banks to 9 percent per year (against a 15 percent annual rate during the first quarter), threatened to bring the entire credit system down. Banks' lending slowed to virtually zero.

Pittsburgh National Bank economist Norman Robertson calls this "the largest two month decline in thirty years" (see chart). The economy dropped out so fast that even *Wall Street Journal* columnist Lindley Clarke, Jr., Milton Friedman's voice on that newspaper, proposed May 13 that the Federal Reserve remove the statutory 9 percent rule. In any event, rather than let the entire financial system come down with a crash—a month ago top New York investment bankers had put their entire personal fortunes into short-term Treasury bills in expectation of such a crash—the Federal Reserve brought the Federal Funds rate down by 8 percent in less than three weeks, taking the major pressure off the commercial banking system.

As the *Economist* of London critique suggests, the Fed and administration are now attempting to "fine-tune" a depression through the most incompetent possible methods. For example, the White House is reportedly not displeased by a Federal judge's May 13 decision to postpone the \$10 per barrel surcharge on imported oil. Reportedly, administration economists fear that the new tax on top of other strains would yield uncontrolled disintegration of the economy. Even for an administration whose leading policymakers wrote the 1979 Council on Foreign Relations statement that "controlled disintegration of the world economy is a legitimate objective for the 1980's," this is something to give pause.

The issue of the defense budget hoax is also revealing. We now know that despite the burst in defense spending during the last quarter of 1979, the current state of defense procurement is exceedingly parsimonious; the administration has actually deferred some spending in order to show a paper increase of 3 percent in military spending between the Fiscal 1980 and Fiscal 1981 budgets! The current year's budget deficit will now undoubtedly top \$70 billion, and the budget deficit next year could "easily" top \$100 billion due to the loss of revenues through the depression. This deficit does not even count about \$70 billion in off-budget financing. Some Wall Street analysts are predicting a sharp interest rate upturn, not only because of the excessive volume of Treasury financing, but because corporations delayed payment of April taxes, in effect borrowing from the Federal government, and will have to come onto the loan market to make up these payments.

There is no longer a middle ground between hyperinflation and general industrial collapse, contrary to the *Economist's* illusions. That has already been demonstrated in computer simulations. Now it has also been demonstrated by the headlines of the financial press.

<b>Domestic Commercial and Industrial Loans</b>		
<b>Per Annum Rates of Growth</b>		
	<b>1st Quarter 1980</b>	<b>Last six weeks</b>
<b>NYC Banks</b>	4.4%	-7.7%
<b>Money Center Banks (including NYC)</b>	10.4%	-6.9%
<b>Regional Banks</b>	19.6%	5.7%
<b>All Large Commercial Banks</b>	15.6%	0.3%